



***Michael C. Schlachter, CFA  
Managing Director & Principal***

March 23, 2011

Dr. Louis Moret  
Chair, Investment Policy Subcommittee  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Revision of Real Assets Policies

Dear Dr. Moret:

You requested Wilshire's opinion with respect to the proposed revisions to the Real Assets policy and its three attachments.

### **Recommendation**

**Wilshire recommends that the Policy Subcommittee adopt the revised policies for Infrastructure and Forestland since there were no material changes made to these policies as they were restructured into the new format.**

**Wilshire will defer to the Real Estate consultant for comments regarding the Real Estate policy, except to note that section II.A.2 changes the intent of the entire Real Estate portfolio from "risk adjusted returns" to primarily "stable cash yields." This is consistent with the change in the nature of the Real Estate portfolio as outlined through the asset allocation process.**

**We also note that the agenda item details Staff's desire to be allowed to approve transactions that will intentionally exceed the parameters of the Real Estate policy through the transition period of five to seven years with quarterly reporting to the Investment Committee. We have worked with Staff and PCA to develop a method for reporting such transactions to the Investment Committee on a more immediate basis and are comfortable with this request.**

### **Discussion**

The transition of the portfolio will take several years and many transactions. There may be times in which Staff undertakes a transaction that exceeds the parameters of the policy or worsens the degree of violation of a parameter while still acting in the best interest of the overall portfolio. However, in our opinion, granting Staff the ability to undertake such transactions autonomously can open the door for potentially unwanted risk in the future. As a result, we have worked closely with Staff and PCA over the

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last week to develop language that allows Staff to operate in the best interests of the fund and that immediately notifies the Investment Committee when intentional and necessary parameter violations occur.

We agree with Staff that seeking Investment Committee approval for every transaction in advance is likely an unworkable solution. Therefore, we agree with the language in the agenda item that proposes that Staff and the Real Estate consultant be required to report to the Investment Committee Chair immediately when Staff plans to engage in a transaction that violates the policy parameters. We believe that this proposal allows for Staff to transact in an expedient manner while still maintaining a proper control environment.

Please let us know if you have any questions or comments.

Best regards,

A handwritten signature in black ink, appearing to read 'Michael A. Smith', with a long horizontal flourish extending to the right.